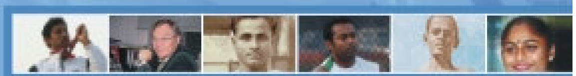

STATEMENTS & GUIDANCE NOTES ISSUED BY ICAI

STATEMENTS

1.00 Authority

The 'Statements' have been issued with a view to secure compliance by members on matters, which, in the opinion of the Council, are critical for the proper discharge of their functions. Statements are therefore mandatory. Accordingly while discharging the attest function, it will be the duty of the members of the Institute :-

a. To examine whether 'Statements' relating to accounting matters are complied with the presentation of financial statements covered by their audit. In the event of any deviation from the statements, adequate disclosure should be made in the audit reports.

b. To ensure that the statements relating to auditing matters are followed, if, for any reason, a member is not able to perform an audit in accordance with such statements, his report should draw attention to the material departure therefrom. The ICAI has published 'Handbook of Auditing Pronouncement (Volume I) Compendium of Statements and Standards' wherein the Statements are given.

2.00 A list of statements on Auditing and Accounting

The 'Statements' have been issued with a view to secure compliance by members on matters, which, in the opinion of the Council, are critical for the proper discharge of their functions. Statements are therefore mandatory. Accordingly while discharging the attest function, it will be the duty of the members of the Institute :—

i. Statement on Auditing Practices. (withdrawn in March 2005 pursuance to the issuance of a number of AAS and Guidance Notes on the topics covered by the said statement)

ii. Statement on Payments to Auditor for other services.

iii. Statement on Qualification in Auditor's Report.

iv. Statement on the Companies, (Auditor's Report) Order, 2003 (issued under section 227(4A) of the Companies Act, 1956)

2.01 Statement on Payment to Auditor for Other Services

Payment of fees for other services rendered by the firm of Auditors is legal. As per Companies Act, 1956 the disclosures of fees paid to auditor for audit work, for taxation matters or for other services have to be disclosed separately. The statement recommends that the disclosure may be given separately.

2.02 Statements on Qualification in Auditor's Report

The statement deals with —

Reporting requirement under Companies Act —

- The matter which the auditor have to report upon could be classified into

    a. Statements of facts and

    b. Opinion.

- Special matter in Auditor's Reports — under Section 227(1A) of the Companies Act

- Qualifications in the Auditor's Report — Aspects to be considered while qualifying reports, manner of qualifying reports and examples thereof.

- Necessity and importance of separate report to Directors.

- The council of the ICAI has issued Auditing and Assurance Standard (AAS)-28 : The Auditor's Report on financial statements. The AAS-28 lays down the principle to be followed in making qualification in the Auditor's Report. The statements on Qualification in Auditor's Report provide *inter alia* the guidance on the application of principle contained in AAS. However, in the case of any inconsistency between the two, the requirements laid down by AAS-28 shall prevail.

2.03 Statement on Companies (Auditor's Report) Order, 2003

The Central Government issued Companies (Auditor's Report) Order, 2003 (CARO, 2003) vide notification dated 12th June, 2003. The order is applicable to certain companies. The Guidance Note provides the guidance to the members while complying with the said Order. It deals with the aspects mentioned in the Order clause by clause. It mentions the precautions to be taken by the member while reporting and documentation thereon. CARO, 2003 supersedes the earlier Order on MAOCARO.

CARO 2003 was modified vide notification No. GSR766(e) dt. 25-11-2004 by issue of Companies (Auditors Report) (Amendment) Order, 2004. To take care of these amendments the statement is revised by ICAI.

GUIDANCE NOTES

1.00 Guidance Notes are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so. Similarly while discharging his attest function, a member should examine whether the recommendations in a Guidance Note relating to an accounting matter have been followed or not. If the same have not been followed, the members should consider, keeping in view the circumstances of the case, a disclosure in his report necessary.

2.00 The ICAI has published Handbook of Auditing Pronouncements (Volume II) Compendium of Guidance Notes. This volume contains around 33 Guidance Notes issued by ICAI. In addition to this there is another publication of ICAI — Compendium of Guidance Notes Accounting, which contains around 23 Guidance notes. The following is the brief introduction to some of the Guidance Notes issued by the ICAI. The members are requested to refer to the text of the notes for complete guidance.

2.01 Terms used in Financial Statements

This Note contains broad and basic definitions of certain important terms used in the preparation and presentation of financial statements. The objective is to clarify the meaning of these terms so as to establish their significance and promote their understanding by preparers and users of financial statements.

2.02 Mode of Valuation of Fixed Assets

This Note deals with certain transitory provisions applicable to fixed Assets due to the changes brought about by the introduction of Companies Act, w.e.f.
1-4-1956.

2.03 Treatment of Reserve Created on Revaluation of Fixed Assets

This Note details the accounting treatment on revaluation of assets and creations of corresponding reserve. It allows the revaluation reserve to be used only for the purpose of setting off the additional depreciation charged due to revaluation. However, it recommends the entities not to charge the additional expenditure to Revaluation Reserve but to the Profit and Loss Account, as it is a prudent approach. For accounting treatment of revaluation reserve in Amalgamations, please see AS-14 — Accounting for Amalgamations.

2.04 Guarantee and Counter Guarantees Given by Companies

The Note discusses the various kinds of Guarantees/Counter Guarantees given by the Companies and the nature of each for the purpose of disclosure of the expected/contingent liability in the financial statements.

2.05 Accounting for Changing Prices

This Note provides basic information on inflation accounting and the different methods of accounting for it. The Note recommends large enterprises to disclose inflation-adjusted figures along with the traditional accounts. It recommends the adoption of current Cost Accounting methods for Inflation adjustments.

2.06 Guidance Note on Accrual Basis of Accounting

Consequent to the amendments made in the Companies Act in 1988 requiring all companies to maintain accounts under accrual system, this Guidance Note provides a comprehensive background on the subject. It discusses the concept of accrual vs. cash methods and provides general guidance on recognition of revenues, expenses, assets and liabilities under this method. The concept of materiality in case of non-compliance and manner of reporting by the auditor is also discussed therein.

2.07 Accounting for Depreciation in Companies

This Note discusses the various aspects of accounting for depreciation including the methods of charging depreciation, change in the methods of charging depreciation, relevant rates of depreciation, *pro rata* computation of depreciation, charge of depreciation in case of revaluation of assets, and other matters arising on account of amendments to the Companies Act, 1956.

2.08 Some Important Issues arising from the Amendments to Schedule XIV to the Companies Act, 1956

Certain important amendments to Schedule XIV were made in December 1993 such as inclusion of continuous process plant as a category of asset for depreciation rate and depreciation of low value items at 100%. This Guidance Note discusses the impact of these changes and the issues arising therefrom.

2.09 Availability of Revaluation Reserve for Issue of Bonus Shares

This Note emphasizes the Institute’s view that bonus shares cannot be issued by capitalisation of revaluation reserves. It also prescribes the manner of qualification to be given by the auditor in case the company has issued bonus shares by capitalizing revaluation reserves.

2.10 Accounting for Leases

This Note is not applicable in respect of assets leased during accounting periods commencing on or after 1-4-2001. In respect of such assets AS-19 — Leases, which is mandatory in nature is applicable.

2.11 Accounting for Corporate Dividend Tax

The Note recommends that the liability for CDT should be recognized in the accounts of the year in which the dividend is recognized by a separate disclosure ‘below the line’. The liability on account of CDT should be disclosed separately under the head ‘Provisions’ in the Balance Sheet.

2.12 Accounting Treatment for Excise Duty

This Note discusses the nature of excise duty and recommends that excise duty should be treated as a manufacturing expense and included in inventory valuation. Where provision for such liability is not made in the accounts, the auditor should qualify his report.

2.13 Accounting for Investments in the Financial Statements of Mutual Funds

Since AS 13 'Accounting for Investments' is not applicable to investments by Mutual Funds, this Guidance Note has been issued to provide guidance on the same. It prescribes that in case of investments by Mutual Funds (except UTI), the carrying value should be determined by reference to its market value on the date of the Balance Sheet and the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

2.14 Accounting for Equity Index Futures

This Note deals with the accounting treatment of equity index futures from the viewpoint of the parties who enter into such futures contracts as buyers or sellers. It provides detailed recommendations on the accounting aspects of such transactions. It also prescribes certain disclosure requirements in such cases. With the issuance of Guidance Note on accounting for equity index and equity stock futures and options, this Guidance Note stands withdrawn.

2.15 Accounting for Dotcom Companies

This Note prescribes the treatment of certain transactions, which are unique to Dotcom companies. They include cases such as the timing and amount of revenue to be recognized from online sales/auctions and membership fees, the valuation and accounting of advertising barter transactions, the identification and financial recording of website development costs, rebates and discounts offered and loyalty programmes for members. It also prescribes certain disclosure requirements for Dotcom companies.

2.16 Accounting for Equity Index Option and Equity Stock Option

This Note deals with accounting treatment of equity index option and equity stock option from the view point of the parties who enter into such option contract as buyers or sellers. With the issuance of Guidance note on accounting for equity index and equity stock futures and options, this Guidance Note stands withdrawn.

2.17 Accounting for Oil and Gas Procuring Activities

This Note aims at providing guidance on accounting for costs incurred on activities relating to acquisition of mineral interests in properties, exploration, development and productions of oil and gas. The Guidance Note suggests that there are two alternative methods for accountings for acquisition, exploration and development costs viz.

a. Successful Efforts Method (SEM) and

b. Full Cost Method (FCM). On overall considerations SEM is recommended to be the preferred method.

2.18 Accounting for Securitisation

Securitisation is the process by which financial assets are transformed into securities. The Guidance Note deals with accounting for securitisation transactions in the books of Originator, specially addressing the issues such as when to securitise the secured assets, treatment of securitisation of future receivables, measurement of consideration received in the form of securities, etc. It also deals with accounting for securitisation transactions in the books of Special Purpose Entities (SPE).

2.19 Accounting for Employee Share-based Payments

Some employers use share-based payments as a part of remuneration package for their employees.

This Guidance Note establishes financial accounting principles for employee share-based payment plans, *viz*., ESOPs, ESPPs and stock appreciation rights.

2.20 Accounting for State-level Value Added Tax

The State Level Value Added Tax comes into effect from 1st April, 2005 in place of the sales tax structure prevalent in various States. This Note provides guidance in respect of accounting various aspects of State-level Value Added Tax (VAT) including accounting for credit/set off available for input tax paid on purchases and accounting for VAT payable on sales.

2.21 Accounting by Schools

The Guidance Note recommends application of sound accounting principles pertaining to recognition, measurement and disclosure of various items of income and expenses, assets and liabilities in the financial statements of schools keeping in view the peculiarities of the activities and formats of financial statements keeping in view not-for-profit being the objective of the school, with a view to harmonise the accounting practices being followed

2.22 Recognition of Revenue by Real Estate Developers

The term 'real estate' refers to land as well as building. The Guidance Note recommends principles for recognition of revenue arising from real estate sales by the enterprises engaged in such activities (commonly referred to as real estate 'developers', 'builders' or 'property developers').

2.23 Accounting for Fringe Benefits Tax

The Finance Act, 2005 has introduced Chapter XII-H in 'Income Tax on Fringe Benefits' governing the Fringe Benefit Tax. The Note is being issued to provide guidance on accounting for Fringe Benefit Tax (FBT), particularly with regards to the recognition and presentation of FBT in the financial statements.

2.24 Provision for Proposed Dividend

This Note requires an auditor to qualify his audit report in case the management does not provide and disclose the provision for proposed dividend.

2.25 Provision for Liability for Taxation

Provision for taxation should be made in the accounts at the year-end on the basis of the tax rates available at the time of finalisation. If the provision for taxation is not made, the reason for non/lower provisioning should be disclosed in the accounts.

2.26 Auditing of Accounts of Liquidators

This Note clarifies that the Audit of Liquidators required to be conducted under section 551 of the Companies Act, 1956, would be similar to the norms of a Company. It contains the recommendation of the Research Committee on the contents of the Auditor's Reports in such cases.

2.27 Independence of Auditors

This Note discusses the concept of auditor's independence and the various safeguards in Corporate Law as well as the Chartered Accountants Act, 1949. It concludes with the observation that independence is basically a state of mind and the safeguards in the Companies Act, 1956 and the Chartered Accountants Act, 1949 are adequate.

2.28 Surprise Checks

Surprise checks are considered a desirable part of each audit. They give significant feedback on the internal controls and increase the effectiveness of the audit. This Note contains the recommendation of the Council in this behalf. The element of surprise can be both with regard to the selection of date of visit to the audit and the selection of the items which are subjected to the audit.

2.29 Preparation of Financial Statements on Letter Heads and Stationery of Auditor

It is recommended that the practice of preparing the financial Statements on the stationery of the Auditors should be avoided, since such a practice is liable to be misinterpreted.

2.30 Auditor's Report on Revised Accounts of Companies before Circulation to Shareholders

In some cases, the accounts, duly approved by Board and reported by the Auditors may be revised before their circulation to the members. In such cases, the auditor shall be required to ensure that all copies of the earlier accounts and reports are returned and adequate disclosure of the fact of revision is made in the Notes to the revised accounts. The auditor's report on the revised accounts shall be in substitution of the earlier report. In the opinion of the Council, these general principles are as well applicable to the audit of the accounts of Government Companies as defined in section 617 of the Act.

2.31 Certificate to be Issued by the Auditor of a Company Pursuant to Companies (Acceptances of Deposits) Rules, 1975

This Note highlights the role of the auditors in certifying and reporting under the Companies (Acceptance of Deposits) Rules, 1975. It discusses the audit approach to be adopted as well as the format of certificate to be issued.

2.32 The Duty Cast on Auditors under Section 45MA of the Reserve Bank of India Act, 1934

The role of the auditor, his responsibility and his reporting requirements under the above-mentioned provisions of the statute are covered in this Guidance Note.

2.33 Audit Report and Certificates for Special Purposes

Special Purpose Audit Report are usually required to be given by auditors. This Guidance Note discusses the scope and responsibility of the auditor, and contents and manner of reporting in such cases.

2.34 Accountants' Report on Profit Forecast and/or Financial Forecasts

The Council is of the opinion that the Code of Ethics does not preclude a chartered accountant from associating his name with financial forecasts provided he indicates in his report, the sources of information, the basis of forecasts and assumption made, and the fact that he is not vouching for the accuracy of the forecast. The Guidance Note covers the role of the accountant and advises on the scope and reporting aspects of such financial forecasts.

2.35 Section 293A of the Companies Act, 1956 and the Auditor

The limit imposed on companies for contribution to any political party or purpose w.e.f. 24-5-1985 are discussed in this Note. The Note also advises the auditor to qualify his report in case the contributions made are beyond the limit specified in the section.

2.36 Audit of Fixed Assets

Fixed Assets usually constitute a significant portion of the assets of a company. The audit of fixed assets is, thus, of considerable importance. This Guidance Note discusses the auditor's role in evaluation of internal controls, review of records and verification procedures, and the valuation and disclosure of fixed assets in the Balance Sheet.

2.37 Revision/Rectification of Financial Statements

This Note clarifies that in keeping with the view of the Department of Company Affairs, accounts once adopted at the Annual General Meeting cannot be reopened or rectified under any circumstances. However, in case the Board of Directors reopen/rectify the accounts, the auditor will be required to qualify his report in the manner prescribed therein.

2.38 Audit of Accounts of Non-Corporate Entities (Bank Borrowers)

This Note discusses the various facets of audit of large non-corporate Bank borrowers with emphasis on the aspects of reporting, the format for presentation of Financial Statements as well as Fund/Cash Flow Statements.

2.39 Audit of Abridged Financial Statements

This Note discusses the norms laid down for listed companies sending abridged financial statements to its shareholders under section 219 of the Companies Act, 1956. The Note provide, guidance to members on issues relating to audit of such abridged financial statements apart from prescribing form, content and other requirements of such statements.

2.40 Certification of Documents for Registration of Charges

This Note deals with the statutory provisions, the Forms required to be submitted, the verification procedure of the forms and the certification requirement by chartered accountants, for charges required to be registered with the Registrar of Companies.

2.41 Audit of Inventories

Considering the importance of inventory in the financial statements, this Note provides guidance to the auditor in audit of inventories. It highlights the significance of internal control evaluation, verification of records, presence at physical verification, confirmations from third parties and the examination of valuation and disclosure of inventories in the financial statements.

2.42 Audit of Investments

The role of the auditor and steps to be taken in establishing the existence, valuation and disclosure or investments by an entity are laid down in this Guidance Note.

2.43 Audit of Debtors, Loan and Advances

This Note is intended to help auditor in the audit of current assets such as Debtors, Loans and Advances. It discusses the various control features to be considered, the suitability of direct confirmation procedure and disclosure in the financial statements.

2.44 Audit of Miscellaneous Expenditure Shown in the Balance Sheet

The auditor’s role in identifying, verifying and evaluation of the items appearing under the item ‘Miscellaneous expenditure’ in the Balance Sheet is laid out in this Guidance Note. This Note shall stand withdrawn in respect of audit of financial statements of enterprises for which AS-26 — ‘Intangible Assets’ has become mandatory and in respect of the entity that has chosen to apply AS-26 to account for Intangible Assets.

2.45 Audit of Cash and Bank Balances

The auditors should employ appropriate procedures and obtain sufficient appropriate evidence regarding the existence, right and completeness of Cash and Bank Balances. This Note recommends the auditor to carry out physical verification of cash at the year end and also seek necessary confirmations from banks for balances held by it.

2.46 Audit of Liabilities

This Note prescribe the measures to be taken by the auditor in regard to internal control evaluation, verification and examination of Loans, Creditors, Other Liabilities, Provisions and Contingent Liabilities.

2.47 Format of Audit Certificate to be issued by the Statutory auditor on Cash Flow Statements

The format of certificate required to be given by the Statutory Auditor of listed companies on the Cash Flow Statement is prescribed in this Note.

2.48 Audit Report/Certification of Financial Information in Offer Documents

The role and responsibility of the auditor in verifying the disclosures made by listed companies in its offer documents in accordance with Part 4 of Part A.1 of Clarification XIV, issued by SEBI, is discussed in this Guidance Note.

2.49 Audit of Revenue

This Note prescribes that the auditor should obtain reasonable audit evidence regarding the management's assertion of the occurrence, completeness, measurement and disclosure of revenue.

2.50 Certification of Corporate Governance

This Note provides guidance to auditors on the certification of the compliance of conditions of the Corporate Governance as stipulated in Clause 49 of the Listing Agreement between the Stock Exchange and the auditee. It clarifies the responsibility of the auditor in this regard and provides guidance on the enquiries and verification procedure to be followed before issue of such a certificate. The Note has been revised in February, 2006.

2.51 Sections 227(3)(e) and (f) of the Companies Act, 1956

The amendments to the reporting requirements of auditors by the Companies (Amendment) Act, 2000 are discussed in this Guidance Note. It clarifies the auditor's responsibility in reporting all adverse comments/observations in bold/italics and also prescribes the verification procedures for ascertaining whether any of the directors are disqualified from appointment under Section 274(1)(g) of the Companies Act, 1956.

2.52 Tax Audit under Section 44AB of the Income-tax Act, 1961

This Note gives in details the requirements of the revised Tax Audit Forms and the Auditor's responsibility in the discharge of his functions under this section. There is a limited revision in the Guidance Note last year to incorporate certain points emerged out of the amendments in the Income-tax Act.

2.53 Audit of Accounts of Members of Stock Exchanges

The requirement of compulsory audit of accounts of Members of Stock Exchanges was introduced in 1984. This Guidance Note guides the members in this function by discussing the unique aspects of stock exchanges, the trading mechanism, the accounting aspects in the books of the members of the stock exchanges, etc.

2.54 Audit of Banks

This is a comprehensive Guidance to Branch and Statutory Auditors of Banks in discharging their obligations. It discusses the various requirements of law applicable to the financial statements, income recognition and provisioning norms in Banks and the responsibility of the auditor in this regard. It also discusses the reporting requirements in the Long Form Audit Report to be given by the Statutory Auditors.

2.55 Revision of the Audit Report

This note aims to provide guidance to the members regarding revision of the audit report after the same has been issued, in the case the auditor considers necessary to do so. It lays down the procedure to be followed by the auditor who, subsequent to the Audit Report, becomes aware that the facts may have existed at that date which might have affected his report.

2.56 Special Consideration in the Audit of Small Entities

The Council of the Institute recognizes that audit of small entities gives rise to a number of special considerations. The emphasis of the Note is to describe the characteristics that are commonly found in small entities and indicate how they might affect the application of Auditing and Assurance Standards (AASs) Thus, this includes (a) discussion of the characteristics of small entities and (b) guidance on the application of AASs to the audit of small entities.

2.57 Computer Assisted Audit Techniques (CAATS)

The application of auditing procedures may require the auditor to consider techniques known as Computer Assisted Audit Techniques (CAATs) that use the computer as an audit tool for enhancing the effectiveness and efficiency of audit procedures. CAATs are computer programmes and data that the auditor uses as part of the audit procedures to process data of audit significance contained in an entity's information system. This Guidance Note provides guidance in the use of CAATs.

2.58 Audit of Capital and Reserves

In carrying out the audit of capital and reserves, the auditor is particularly concerned with obtaining sufficient, appropriate audit evidence to corroborate the management's assertions regarding existence, occurrence, obligations, completeness, measurement, valuation, presentation and disclosure. The Guidance Note gives guidance in this regard.